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IN THE

Supreme Court of the United States

OCTOBER TERM, 1969

No. 38

CHARLES E. BRUNDAGE, ET AL., [illegible]ting the NORTHERN PACIFIC STOCKHOLDERS' PROTECTIVE COMMITTEE,

Appellants,

v.

UNITED STATES OF AMERICA, ET AL.,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

BRIEF FOR GREAT NORTHERN RAILWAY COMPANY, ET AL.

ANTHONY KANE
LOUIS E. TORINUS
EARL F. REQUA
FRANK S. FARRELL
ELDON MARTIN
R. T. CUBBAGE

RICHARD J. FLYNN
1625 I Street, N.W.
Washington, D.C. 20006

HUGH B. COX
888 Sixteenth Street, N.W.
Washington, D.C. 20006

RAY GARRETT
D. ROBERT THOMAS
LEE B. MCTURNAN
11 South LaSalle Street
Chicago, Illinois 60603

Attorneys for Great Northern Railway Company, et al., Appellees

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TWENTIETH CENTURY PRESS, INC., CHICAGO 60606

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STATEMENT

1. Introduction

This appeal by a minority group of Northern Pacific stockholders is one of four related appeals arising out of the District Court's affirmance of the orders of the Interstate Commerce Commission authorizing consummation of the Northern Lines merger. Appellees Great Northern Railway Company (GN), Northern Pacific Railway Company (NP), Pacific Coast R.R. Co. (Pacific), Chicago, Burlington & Quincy Railroad Company (Burlington), Spokane, Portland and Seattle Railway Company (SP&S), and Great Northern Pacific & Burlington Lines, Inc., intervening de-

fendants in the proceedings before the District Court, are the railroads authorized to carry out the transactions approved by the Commission.[1]

In February, 1961, these carriers filed an application with the Interstate Commerce Commission pursuant to Section 5(2) of the Interstate Commerce Act (49 U.S.C. Sec. 5(2)) seeking authority to merge GN, NP, Pacific and Burlington into Great Northern Pacific & Burlington Lines, Inc., a newly formed company, and for that company to lease the properties of SP&S (App. 6-9).

As between GN and NP, which have a substantially equal number of shares of stock outstanding, the merger agreement submitted to the Commission provides that the stockholders of each company will receive common stock of the merged company on a share-for-share basis, and that GN stockholders will receive, in addition, one-half share of the merged company's $10.00 par value 5½ percent non-voting preferred stock for each share of GN stock. This preferred stock is to be retired, through the operation of a mandatory sinking fund, over a 25-year period beginning with the fifth anniversary of the merger, and may be redeemed at the option of the merged company after the fifth anniversary (App. 42-43).

In reports issued in 1967 and 1968, the Commission approved these proposals, including the merger terms, subject to numerous conditions imposed by the Commission that are unrelated to these terms. *Great Northern Pacific & Burlington Lines, Inc.—Merger, etc.—Great Northern Railway Company, et al.*, 331 I.C.C. 228 (1967),

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[1] A more complete description of the applications, the carriers involved and the proceedings, both before the Commission and in the District Court, is set forth in the brief filed by these appellees in the related appeals in Docket Nos. 28 and 43.

331 I.C.C. 869 (1968) (App. 245, 457).[2] Complaints seeking to enjoin and set aside the Commission's orders were filed in the United States District Court for the District of Columbia by several parties, including the appellants Brundage, Story, Williams and Clark, comprising the self-constituted Northern Pacific Stockholders' Protective Committee (NPSC).

In its complaint, NPSC challenged only the corporate merger terms between GN and NP, which the Commission, in approving the proposed transactions, had found to be just and reasonable. Basically, NPSC seeks to have certain NP natural resources properties excluded from the transactions approved by the Commission, or, failing that, to have the stock exchange ratios altered in favor of the present NP stockholders. Evidence on these subjects had been presented both by NPSC and by the applicants at the hearings before the Commission.

After receiving briefs and hearing argument, the District Court, on November 20, 1968, issued its opinion and ordered the dismissal of all of the complaints challenging the Commission's orders. *United States* v. *United States*, 296 F. Supp. 853 (D. D.C. 1968) (App. 1).

The issues raised by NPSC on appeal are, as in the court below, different from those raised by other appellants. NPSC's sole concern is with increasing or rearranging the interests that NP stockholders will receive as a result of the transactions approved by the Commission. NPSC contends that the Commission's finding that the agreed stock exchange ratios are just and reasonable is not supported by substantial evidence, and that both the Commission and

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[2] Other reports of the Commission in these proceedings (not relevant to this appeal) are published at 328 I.C.C. 460 (1966) and 333 I.C.C. 391 (1968) (App. 61, 498).

the District Court failed to consider either the whole record or the parts relied upon by NPSC (NPSC Br. 3, 13). Similarly, NPSC contends that the Commission's finding rejecting NPSC's proposal for sale of NP's natural resources properties is not supported by substantial evidence, and that the District Court failed to review the relevant part of the record (NPSC Br. 51, 55). Finally, NPSC contends that the Commission erred in refusing to reopen its proceedings in 1967 and 1968 to afford NPSC a further hearing with respect to merger terms (NPSC Br. 11, 37).

A review of the record, together with the reports of the Commission and the opinion of the District Court, demonstrates that each of these contentions is without merit.

2. The Evidence Before the Commission

The detailed evidence presented by applicants with respect to the negotiations leading to the agreement between GN and NP on the financial terms of their proposed merger, and by NPSC in opposition to those terms, is reviewed in the Examiner's Report (App. 784-813),[3] the Commission's report on reconsideration and further hearing (App. 289-296), and the opinion of the District Court (App. 43-45).

The record shows that in 1955 officials of GN and NP began discussions of terms of a merger "and thenceforth engaged in extensive negotiations . . ." (App. 43). These discussions and negotiations continued until June 2, 1960 —a period of almost 5½ years—when the managements of the two companies agreed upon the stock exchange ratios.

The details of these negotiations were described on the

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[3] The Examiner's Recommended Report (App. 507-1257) was made a part of the Commission's orders approving the merger (App. 457, 496).

record by Mr. Macfarlane, President of NP.[4] He testified that the negotiations were conducted between the NP Board of Directors and its consolidation committee (on both of which he served) and the GN Board of Directors and its consolidation committee. To aid these negotiators in arriving at equitable merger terms, NP retained Morgan Stanley & Co. and GN retained First Boston Corporation as their respective financial advisers.[5] In addition, recognizing that the NP's natural resources properties represented a potentially difficult problem in establishing terms, GN employed Pishny and Atkinson, of Fort Worth, Texas, to evaluate NP's oil and gas reserves, and Schultz & Company, Incorporated, of Seattle, Washington, to evaluate NP's timber resources. NP employed DeGolyer and MacNaughton, of Dallas, Texas, and Mason, Bruce and Girard, of Portland, Oregon, to make similar evaluations on its behalf. The two companies jointly employed an independent transportation engineering firm to study the properties and evaluate the advantages and savings to be achieved through merger. (Tr. 89-90, 95; App. 43, 256, 289, 290)

On the basis of their independent studies, First Boston advised GN that, considering only earnings from railroad operations and common sources (*e.g.*, Burlington and SP&S), GN contributed 66 percent and NP 34 percent of the combined earning power of the two companies; Morgan Stanley advised NP that, on the basis of these earnings, the ratio was 60-40 in favor of GN (Tr. 96, 99, 1003-04; App. 290, 787, 791).

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[4] Mr. Budd, President of GN, concurred in and confirmed Mr. Macfarlane's testimony (Tr. 171).

[5] Mr. Payne, a partner in Morgan Stanley & Co., testified to his firm's participation in the negotiations (Tr. 315, 322-337), as did Mr. Dobson, an officer of First Boston (Tr. 386-392).

Pishny and Atkinson estimated that the fair value of the NP oil and gas resources was $46.8 million on the basis of a possible sale (Tr. 94). DeGolyer and MacNaughton estimated that the net worth of the NP oil and gas properties as a going concern was $59.4 million, but indicated that this was substantially in excess of the price for which the properties would sell in a fair market transaction (Tr. 92-93). Schultz & Company estimated that the value of the timber resources (exclusive of grazing and cultivation lands) was $45.1 million, and that the grazing and cultivation lands were worth $4.5 million. Mason, Bruce and Girard estimated that the value of the timber resources was $62.2 million, with a potential value of $79.7 million, assuming improved management to obtain maximum recovery on a sustained yield basis (Tr. 93-94). NP, utilizing its own technical staff, estimated that the value of its mineral properties (other than oil and gas) and its grazing and cultivation lands was approximately $48.7 million (Tr. 94).

In short, there was a substantial difference between the two sets of natural resources estimates and in the bases, methods and theories used in arriving at the estimates. The estimates made for GN were approximately $30 million lower than those made for NP. NP, however, recognized that the appraisals it received were substantially in excess of what the properties would bring if sold, and that a substantial part of the proceeds of sale would be taxable as capital gains (App. 786).

After considering the valuation reports and methods of valuation, and taking into account taxes and depletion, NP's financial adviser, Morgan Stanley & Co., arrived at a judgment figure of $115 million to $125 million as the value of the non-railroad properties of NP, including industrial properties (Tr. 96; Ex. 32, p. 26; App. 788). On the basis of this estimate, Morgan Stanley & Co. pro-

posed a share-for-share exchange for both companies (Tr. 96; App. 290). First Boston, on the other hand, valued the NP natural resources properties primarily on the basis of earnings, and recommended that GN stockholders be favored over those of NP by a ratio of 1.2 shares to 1 (Tr. 2591; App. 789).[6]

In subsequent negotiations, the parties agreed that the industrial properties held by NP (and included in the Morgan Stanley valuation of NP's non-railroad properties) should not be considered separately from NP's railroad properties, since similar GN properties had been included in its railroad properties. The NP valued at about $32.7 million the industrial properties thus removed from Morgan Stanley's valuation of NP's non-railroad properties and included in its railroad properties (Tr. 1001, 1052; App. 290-291, 787, 789).

The parties and their advisers gave consideration to the possibility of segregating the NP natural resources properties from its railroad properties. One course considered was the establishment of two classes of stock, one related to the NP natural resources properties which would be distributed only to NP stockholders, and the other related to the rail operations to be distributed to the stockholders of both companies. This possibility was rejected because of probable difficulties of the board of directors of the merged company in administering the different kinds of property for two classes of stockholders with divergent interests (Tr. 97, 1170-73; App. 44, 291, 790). The negotiators also considered spinning off the natural resources properties

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[6] As noted above (p. 5), on the basis of earnings from railroad properties and common sources alone, without considering the NP natural resources properties, the First Boston study would have produced a ratio of about 2 to 1 in favor of GN stockholders, and that of Morgan Stanley & Co. a ratio of 1.5 to 1, also in favor of GN stockholders.

prior to merger. This alternative was rejected because of the problems which would arise with mortgage trustees and bondholders and the consequent prospects of protracted litigation of doubtful result, as well as the possible prohibitive tax consequences of such a transaction (Tr. 97-98; App. 44, 291, 790; see pp. 14, 18-19, below).

Reaching the conclusion that the NP natural resources properties would have to be included in the merger, GN and NP requested their respective financial advisers to seek terms each adviser could recommend to its principal as a basis for further negotiation (Tr. 98; App. 291). It became clear that if there were to be a merger, concessions would have to be made by both GN *and* NP (Tr. 100; App. 792). GN, accordingly, yielded in its view that its greater earning power required that its stockholders be given a larger share of the earnings of the combined enterprise on a permanent basis, and NP modified its contention that the combination of its rail earnings and natural resources properties entitled it to immediate equality (Tr. 119-122, 2591; App. 44, 291, 792-794).

Having considered the widely varying appraisals of the natural resources and the railroad properties, the parties adopted weighted earnings as the principal basis for fixing exchange ratios (App. 294-295, 802). In adopting this basis, the parties recognized that a definitive valuation of either the railroad properties or the natural resources properties was at best difficult, and probably impossible, and that, in any event, since neither class of property was readily saleable, both were basically worth what they could earn (App. 792). Since the earnings, dividends and market prices of GN had been higher than those of NP, NP conceded that the GN stockholders should receive something more than a share-for-share exchange

(Tr. 119-122). The terms arrived at gave recognition to these factors by providing for the issuance of preferred stock to GN stockholders. At the same time, the agreed terms provided for mandatory retirement of that stock and thereby preserved for NP stockholders on a long term basis approximately equal participation in the earnings of the combined enterprise (App. 291). The Morgan Stanley partner who testified at the hearings stated that his firm "suggested the preferred stock as a method of bringing together the gap in the negotiations between the Great Northern and Northern Pacific and ending up share-for-share on the common stock" (Tr. 2478). On the basis of historical earnings, the terms favored NP stockholders (App. 292).

Morgan Stanley & Co. advised NP that it considered the final terms fair and equitable to the stockholders of both railroads, and First Boston concurred with this judgment in its advice to GN (Tr. 326-327, 388; App. 45, 291). The terms were approved by the boards of directors of both companies in July, 1960, and, in 1961, were approved by the NP and GN stockholders (App. 291-292). The NP stockholders' vote was 73.81 percent in favor of the merger and 6.64 percent against, with the balance not voting (App. 292).

In August, 1961, subsequent to these initial votes of stockholders, NPSC was organized for the express purpose of excluding the NP natural resources properties from the merger. As its Chairman, Mr. Brundage, testified:

> "Our committee was not organized for the primary purpose of obtaining a change in stock ratios more favorable to Northern Pacific stockholders but instead to enable the Northern Pacific stockholders to retain their present exclusive ownership of the natural resources properties of Northern Pacific." (Tr. 9924)

NPSC solicited authority to represent other NP stockholders in the merger proceeding (Ex. 145, Part A; App. 807), and at the time of the hearings, represented about 3 percent of NP's shareholders and 5 percent of its outstanding stock (App. 292, 803).

NPSC intervened in the proceedings before the Commission and proposed that the Commission order a segregation and sale of NP's natural resources properties prior to merger (App. 292-293). Under the NPSC proposal, these properties would have been sold to a proposed new land company at a price of about $117 million (App. 294).[7] The price proposed by NPSC to be paid to NP was to be based on the Morgan Stanley & Co. minimum judgment value of $115,000,000, reduced to $96,000,000 by excluding industrial lands on a pro rata basis, and then increased by some $20,000,000 to cover capital gains tax, resulting in a gross price of about $117,000,000, so that Northern Pacific would retain the intended amount of about $96,000,000 (Tr. 9929-30, 9938, 9959, 9982; App. 809-810). NP stockholders would have been given the right to subscribe to the stock of this proposed new land company at about $20 per share, with all stock not so subscribed to be sold to the public (App. 294). Alternatively, NPSC proposed that the NP exchange ratio be constructed on the basis of the "market value" of the natural resources properties, rather than primarily on weighted earnings, or, if earnings were used, that a "very high" price-earnings ratio be applied to the earnings from these properties (App. 294-295).

To support its contentions, NPSC offered the testimony of five witnesses, consisting of three members of NPSC

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[7] This plan was presented for the first time at the hearings, some 15 months after the application was filed and seven months after the hearings began (App. 809).

(Messrs. Brundage, Williams and Story), a petroleum engineer, and an officer of a management company.

Mr. Brundage expressed dissatisfaction with the valuations by the experts and witnesses of applicants, but left the matter of valuation open except for stating his opinion that, in the absence of segregation, the ratios would be unfair to the Northern Pacific stockholders unless they received 1.5 shares for each share issued to GN shareholders (Tr. 9925). Mr. Brundage discussed the "judgment value" recommended by Morgan Stanley & Co. of $115,000,000 to $125,000,000, which he characterized as "wholly inadequate," and the methods and principles used, which he asserted were "fallacious" and "erroneous" (Tr. 9910-13). Despite these criticisms, he, himself, offered no substitute value or appraisal of the natural resources. He testified that:

> "We recognize the enormous difficulties faced by the negotiators and their financial consultants in arriving at the proposed terms of merger. The natural resource properties of Northern Pacific defy anything approaching an exact appraisal. Perhaps the observation nearest of any to the truth appeared in the Prospectus of the Northern Pacific for the 1954 issue of Collateral Trust, four per cent, 1984, that 'the extent and aggregate value of such properties are stated to be unknown'." (Tr. 9925)

Mr. Williams of NPSC was even less specific. After comparing the natural resources with those of three other concerns engaged in exploiting natural resources properties, he testified that in the judgment of NPSC the natural resources of NP would warrant a market value of 50 times 1961 earnings, or $295,000,000 as the minimum consideration NP should be required to accept in an outright sale or in a merger (Tr. 10000-01). His opinion was based entirely upon his statistical studies of market behavior in

other cases, as he did not claim to be an expert appraiser except in the case of securities (Tr. 10003-04). Although he arrived at a price of $295 million for the natural resources, the total market value of NP's outstanding stock (reflecting ownership of both natural resources *and* railroad properties) was some $50,000,000 *lower* than Mr. Williams' valuation of the natural resources alone (Tr. 10020).

Mr. Story of NPSC offered no valuation; in his testimony (Ex. 146) he directed himself solely to matters of "conventional business inflation" and "monetary inflation." Through statistics, charts and publications he arrived at the following conclusion: "[W]e believe that to assure fairness to Northern Pacific stockholders in the proposed merger they must be given the opportunity to continue their present exclusive ownership of their equity in natural resource properties" (Ex. 146, p. 13). Among other things, he stated:

> "To measure the value of oil, timber or coal lands at the chance price of a given moment of time is likely to result in grave error." (Ex. 146, p. 4)

He declined to predict or forecast what the price of anything would be at any time in the future; he merely predicted the obvious, that if the forces of inflation continue upward there will be an increase in prices (Tr. 10038-43).

Mr. Keplinger, a consulting petroleum engineer and geologist from Tulsa, Oklahoma, testified for NPSC (Tr. 10057-71) that he had studied the two reports of DeGolyer and MacNaughton (Exs. 29 and 30) and the NP appraisal report (Ex. 31), found the valuation of the undeveloped mineral rights (Ex. 29) entirely inadequate, and conferred with Mr. George Washington, head of the Oil Development Department of Northern Pacific. He stated that he had

been retained by NPSC probably in September, 1961; that he spent about half a day with Mr. Washington the week before he testified on May 17, 1962; and that he did not make a detailed study of the oil reserves (Tr. 10072). On the matter of valuation he had only this to say:

> "At best, it is difficult to arrive at the present worth of these unique and extensive oil and gas interests of Northern Pacific. At worst, it is impossible to place any exact valuation figures on them." (Tr. 10066)

Mr. Sutton, an officer of Apache Corporation, a management company employed by NPSC, testified after only two days of preparation that a range of $112,000,000 to $117,000,000 is a fair figure for a sale of NP's natural resources properties (Tr. 10054; 10128-29). This valuation is not substantially different from the judgment value arrived at by Morgan Stanley & Co. Mr. Sutton also testified that, on the basis of his two days' study of the NPSC plan, and subject entirely to what he was told by NPSC as to the NP mortgages, in his opinion it would not be difficult to raise $112,000,000 to $117,000,000 of capital (Tr. 10052-54). He stated that Apache Investment Securities, Inc., a subsidiary of his company, does underwriting and could participate to the extent of $40,000,000, although its greatest participation in any underwriting so far had been only $4,000,000 (Tr. 10137-38). He further testified that at an offering price of $19.00 to $19.50 per share and an underwriting cost of 50 cents per share (Tr. 10142-43), the underwriters' fee would be about $3,000,000 even if all of the 32,000 stockholders purchased their full proportion of land company stock. The net proceeds to the land company would thus be no more than $109 million to $114 million, or $3 million to $8 million less than the gross price of $117 million that NPSC proposed to have the land company pay NP.

In opposition to the NPSC plan, Mr. Macfarlane pointed out that the present NP stockholders would participate only to the extent they were able and willing to pay about $20 per share, all stock not subscribed by them to be sold to the public. He stated that, in his opinion, to place the stockholders in a position of having to pay a substantial amount of additional money as a mandatory price of retaining any interest in the natural resources would be decidedly unfair (Ex. 215, pp. 1-3).

Furthermore, the natural resources properties involved in the NPSC proposal, which include land grant lands, are subject to the liens of the Northern Pacific Prior Lien and General Lien Mortgages, and these mortgages would have to be dealt with in the proposed sale. Mr. Ince, Vice President of Bankers Trust Company, Trustee of the Prior Lien Mortgage, testified that the position of the Trustee is that the Mortgage does not contain authority for such a release of the land grant lands as a whole and that it would have to refuse to execute a release on request; and, if an action were brought to compel a release, the Trustee would oppose the order and assert such defenses and take such appeals as it deemed necessary (Ex. 220, pp. 1-2). Mr. Smith, Vice President of First National City Trust Company, Trustee under the General Lien Mortgage, expressed a similar and more specific view as to that Trustee's position. He testified that the Trustee would not consent to such sale free from its lien without an affirmative decree in an adversary proceeding in which bondholders would be made parties and with an appeal if the court decision should be adverse to the Trustee's position. Mr. Smith further stated that it would be necessary for the Trustee to apply to the court for an independent appraisal of the land grant lands and direction as to the use of the proceeds as continuing security for the General Lien Bonds (Ex. 221, pp. 5-6).

NPSC's proposal would require the plan of sale to be carried out before any merger of the railroad properties could be accomplished; and the Commission was asked to withhold approval or condition its approval on the carrying out of the proposed sale (Tr. 9956), after the delays and litigation which the proposal would entail.

3. The Commission's Findings and Conclusions

In his recommended report and order, the Examiner, after a detailed review of the evidence, rejected the NPSC contentions and found the merger terms to be just and reasonable (App. 784-813).

Since in its First Report (App. 61) the Commission, on other grounds, did not approve the proposed transactions, it did not therein deal with the issues raised by NPSC. When the applicants sought reconsideration, NPSC sought further hearings with respect to the justness and reasonableness of the exchange ratios (App. 251). The Commission refused to hold further evidentiary hearings for this purpose, but did reopen the proceeding for reconsideration and oral argument on all issues (App. 251, 272-273).

In its report on reconsideration, the Commission, after reviewing the negotiations leading to the adoption of the exchange ratios (App. 286-292) and the proposals of NPSC (App. 292-296), approved the negotiated terms (App. 297). With respect to NPSC's contention that market value, rather than earnings, should be used to value the natural resources properties, the Commission noted that NPSC itself, which had submitted values for these properties ranging all the way from $96 million to $295 million, "is unable to come forward with any definitive valuations" (App. 294, 296). The Commission concluded that the NPSC contention—that the use of weighted earnings as the primary basis of valuing NP's contribution to the combined

enterprise resulted in an unjust and unreasonable valuation of the natural resources properties—was

> "contrary to the record, which shows that the full potential value of the natural resources properties was fully reflected in the shares allotted to the Northern Pacific stockholders." (App. 296)

As to the NPSC proposal for segregation and sale of these properties, the Commission held that the plan was "without merit and unfair to Northern Pacific stockholders" (App. 296). It pointed particularly to the fact that, under the NPSC plan, NP stockholders would be required to "repurchase interests in property they already own, with those failing to do so frozen out of future benefits therefrom" (App. 297).

The Commission concluded by stating:

> "The issue here is whether the exchange ratios are just and reasonable, and limited thereto, we find the record both adequate and affirmative, in that they meet the necessary and required tests: (1) that they are the results of arms' length bargaining, and (2) that they fairly reflect the contributions of each group of stockholders to the combined system. Cf. *Erie R. Co. Merger*, 312 I.C.C. 185, and *Louisville & N.R. Co. Merger*, 295 I.C.C. 457." (App. 297)

After issuance of the Commission's decision approving the proposed transactions, the entire merger proposal, including the exchange ratios, was again submitted to the stockholders of the merging lines (App. 465).

NPSC waged a proxy campaign in connection with this second vote, attempting, on the basis of the arguments presented here, to defeat the proposal by persuading NP stockholders either to vote against the proposal or to withhold their vote. On March 14, 1968, however, 73.20 percent of

the NP stock was voted for the merger, and only 2.57 percent was voted against (App. 46, fn. 20; 465, 471).[8]

On April 11, 1968, the Commission denied a further petition of NPSC again seeking to reopen the proceedings to determine the value of the NP natural resources properties, holding that there were no material errors in its disposition of NPSC's contentions (App. 471).[9]

4. The District Court's Findings and Conclusions

The contentions presented by NPSC to the District Court were essentially those pressed in this appeal (App. 42-46).

The District Court, after reviewing the record before the Commission and the Commission's consideration of the exchange ratios (App. 42-45), stated:

> "The Commission . . . based its approval upon an independent determination, considering the prolonged negotiations involving arms length bargaining as evidence of fairness in the exchange ratio and concluding that the ratio reflected fairly the contributions of each group of stockholders to the combined system.
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[8] It is worth noting, in comparing the two occasions on which the stockholders considered the merger terms, that the vote against the merger declined from 6.64 percent in 1961 to 2.57 percent in 1968, while the combined percentage of stockholders either voting no or not voting increased by only 0.61 percent (App. 46, fn. 20; 292, 465). These changes measure the impact on other stockholders of the seven-year campaign of NPSC.

[9] The Commission corrected "a minor misstatement of fact to the effect that expenses of organizing the new land company [as distinguished from the expenses of sale] would be met by Northern Pacific, whereas NPSC actually proposes that they would be borne in the new land company itself . . ." (App. 471; NPSC Br., App. III, par. 5). It held that this misstatement was not "sufficiently serious as to warrant reconsideration of our previous decision or the further hearing desired by the petitioner" (*ibid.*).

> "This whole matter, including the views advanced by the Committee, was explored in great detail by the Commission. On the basis of the record upon which the Commission relied, we have no reason to rule other than that the ratio which was established, with approval of the companies and of a large majority of their stockholders, is just and reasonable." (App. 45)

The District Court took particular note of the problems inherent in segregating the NP natural resources properties, stating:

> "[A] spin-off free of encumbrances would create problems with mortgage trustees and bond holders, with the prospect of extended litigation and the probability that it could never be consummated successfully; and if a spin-off were subject to the mortgages there would be prohibitive tax consequences." (App. 44)[10]

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[10] The Examiner, who had made the same findings with respect to a spin-off (App. 790), concluded that the same reasons which precluded a spin-off free of encumbrances also precluded the sale proposed by NPSC, stating (App. 812-813):

> "Thus intervener's proposal is impractical of accomplishment and unfair to the Northern Pacific stockholders whom it purports to benefit for several reasons. The natural resources properties are subject to the liens of Northern Pacific's prior lien and general lien mortgages. . . . The mortgages were the major obstacles that caused an abandonment of the spin-off suggestion. Intervener [NPSC] was aware of the problem and agreed that spin-off was impossible. Significantly, the provisions of the prior lien mortgage may preclude a sale at one time of all of the remaining lands now under the mortgage, since the proceeds of such sale would have to be deposited with the trustee of the prior lien mortgage, in order to secure a release of the properties, and applied by the trustee in accordance with the terms of the prior lien mortgage. The trustee (who testified that the prior lien mortgage does not contain authority for release of the land grant lands as a whole under any of the proposals discussed . . .) has veto power over the prices and terms of sale, and the mort-

As it has done here (NPSC Br., Apps. IV-VII), NPSC, to buttress its claim to reopening, departed from the record before the Commission to present more recent earnings for NP and GN, which it contends support its claims that the exchange ratio for NP stock is unjust and unreasonable. Turning to this NPSC contention that the record should be reopened, the District Court held:

> "Moreover, we do not agree that the Commission should be required to reopen the record to update it. We think that such fluctuations as the Committee refers to as possibly relevant are, as the Commission now urges, those normal fluctuations which can be expected to occur during the course of any protracted administrative proceeding and which have no effect upon the ultimate fairness of the Commission's finding. The arguments pro and con reopening cancel out each other sufficiently to leave the discretion exercised by the Commission free of abuse. *United States* v. *Pierce Auto Lines,* 327 U.S. 515, 534-35." (App. 45-46)

The court concluded:

> "[A]lthough we have not specifically discussed each of the arguments advanced by the Committee, we think all significant issues regarding the ratio were fully considered and decided in a manner which requires the court to withhold any direction of its own that the ratio should be different." (App. 46)

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gage limits the use of the proceeds of sale. . . . [I]ntervener fails to grasp the significance of the fact that by its proposal all of the remaining properties would be sold as a package, and as indicated the trustees obviously may not release all of the natural resources properties at one time without appropriate court order. . . . In view of the fact that the suggested price falls short of the amount required to pay off both mortgages (about $150 million), the trustees indicate they would submit to a proper court not only the issue of whether a bulk sale is proper, but also the question of appraisal of the properties for the purposes of a sale of that kind."

SUMMARY OF ARGUMENT

I. The Commission's finding that the exchange ratios for GN and NP stock are just and reasonable is based upon substantial evidence of record, including the testimony of the principal officers of the merging carriers and their respective independent financial advisers, and the reports of expert appraisers. The Commission is not limited to any particular method of establishing the relative value of the contributions of the stockholders of merging carriers. It has broad discretion, so long as its determination has a reasonable basis in findings supported by substantial evidence. The use of comparative earnings to determine an exchange ratio, subject to such modifications and adaptations as the particular case requires, is a method which the Commission is free to adopt.

In this case, the use of comparative earnings as the primary determinant of the exchange ratios was not only an acceptable method, but the only practicable method available. Neither the applicants nor NPSC could provide a definitive valuation of the NP natural resources properties, and the NPSC testimony concerning a price-earnings ratio for natural resources income was inherently incredible.

Based on the evidence showing that the exchange ratios fairly reflected the contributions of each group of stockholders to the combined system, that the negotiations which resulted in the agreed ratios were conducted at arms' length, and that the stockholders had twice approved these terms, the Commission's conclusion that the terms were just and reasonable was entirely correct.

II. In reviewing the Commission's findings concerning the fairness of the exchange ratios, the District Court properly considered its role to be limited to determining whether

the Commission had complied with governing law and whether its conclusions were based on substantial evidence. Since the Commission's opinion clearly reflected the basis of its decision, and the District Court, after reviewing the record, accepted its disposition of the issues, there was no necessity for the court to make detailed findings with respect to each of the arguments of NPSC. The thrust of NPSC's argument is a demand that the District Court substitute its judgment for that of the Commission, a course the court was not free to follow.

III. The fairness of exchange ratios in a merger case arising under Section 5(2) is to be determined on the basis of the record made before the Commission, and the Commission is not required to reopen that record to receive evidence of changed conditions except in the most extreme cases.

The question whether an administrative record need be reopened is one committed to the discretion of the agency, and the agency's exercise of that discretion cannot be set aside except on a clear showing of abuse. Neither the mere passage of time nor the fluctuations in the carriers' earnings and in the market prices of their stocks demonstrate a need for reopening the record. As the District Court found, these variations in financial statistics, on which NPSC relies, are merely the normal fluctuations which can be expected to occur in the course of any protracted administrative proceeding, and do not affect the validity of the Commission's findings.

IV. The Commission's finding that NPSC's proposal for segregation and sale of NP's natural resources properties is without merit and unfair to NP stockholders is supported by substantial evidence, showing both that the plan is impractical and that it would require NP stock-

holders to repurchase property they already own or be frozen out of the benefits to be derived from such ownership. Given the stand taken by the mortgage trustees with respect to a sale such as that proposed by NPSC, the pursuit of such a plan would have presented a prospect of extended litigation and the probability that such a transaction could never be consummated successfully. The District Court, noting that the Commission had fully considered NPSC's contentions in support of its plan, and concluding that its disposition of that issue was based on substantial evidence, properly affirmed the Commission's conclusion.

ARGUMENT

I. THE COMMISSION'S FINDING THAT THE EXCHANGE RATIOS ARE JUST AND REASONABLE IS SUPPORTED BY SUBSTANTIAL EVIDENCE.

NPSC contends that the Commission's finding that the NP-GN exchange ratios are just and reasonable is not supported by substantial evidence. In the light of the evidence of record discussed above, this contention is specious. The detailed testimony of the principal officers of both NP and GN and their independent financial advisers explaining precisely the information upon which the applicants relied and the considerations which led to the final agreement, tested against the criticisms advanced by NPSC, clearly demonstrated that the agreed exchange ratios reflected all elements of value contributed by each group of stockholders and were fair to the stockholders of both GN and NP.

In its report of November 30, 1967, the Commission reviewed the evidence as to the valuation of the properties of GN and NP, referring specifically to the reports of the independent appraisers employed by the applicants to evaluate the natural resources properties of NP, the re-

ports of the independent financial advisers, the problems inherent in arriving at fair and equitable terms for the natural resources properties, the consideration given to methods of segregating rail and non-railroad properties, the adoption of comparative earnings of the merging companies as the primary basis for determining the exchange ratios, and the final agreement on terms approved by the financial advisers and boards of directors of each company and by their stockholders (App. 289-297).

The Commission also gave full consideration to the position of NPSC stating:

> "While agreeing that the current worth of each shareholder's contribution to NuCo is the proper basis for establishing an exchange ratio in rail merger proceedings, NPSC insists that in this instance earnings are not the proper basis for measuring the contribution in relation to the natural resources properties, but rather that the market value thereof should be the determinant factor. However, if earnings are to be the basis for the evaluation, then it contends that it is necessary to employ a very high price-earnings ratio to take into account the potential earnings of the property not currently productive of income. Despite the acknowledged difficulty of arriving at definite evaluations, and it offers none, NPSC urges that such specific findings are necessary before the transaction can be approved. Finally, it urges that applicants have failed to carry the burden of proof in establishing the fairness of the merger terms, and that the uniqueness of the proposed transaction involving natural resources issue requires our most careful consideration." (App. 294-295)

On the basis of the evidence, the Commission found that:

> "NPSC's contentions relative to the . . . propriety of the exchange ratios are . . . contrary to the record,

> which shows that the full potential value of the natural resources properties was fully reflected in the shares allotted to the Northern Pacific stockholders." (App. 296)

The Commission concluded that:

> "The issue here is whether the exchange ratios are just and reasonable, and limited thereto, we find the record both adequate and affirmative, in that they meet the necessary and required tests: (1) that they are the results of arms' length bargaining, and (2) that they fairly reflect the contributions of each group of stockholders to the combined system." (App. 297)

The evidence offered by applicants clearly provides a substantial basis for the Commission's findings and conclusion.

NPSC's attempt to persuade this Court to the contrary rests primarily on the assertion, rejected by the Commission, that no exchange ratio for a transaction which includes the NP natural resources properties can be just and reasonable unless it is based on an "expert asset valuation . . . as to what these natural resources properties would be worth in the market place in dealings between parties free of compulsion" (NPSC Br. 24).

Neither Section 5(2) nor the cases decided under it lend any support to NPSC's contention that the Commission must follow a prescribed formula in determining whether merger terms are just and reasonable. The statutory test is that the ratio be "just and reasonable" (49 U.S.C. Sec. 5(2)(b)); and the question to be answered in meeting this test is whether the agreed ratio reflects "what the stockholders of each of the railroads will contribute to the resulting enterprise." *Stott* v. *United States,* 166 F. Supp. 851, 857 (S.D. N.Y. 1958); *Schwabacher* v. *United States,* 334 U.S. 182, 199. The method of determining these relative contributions, however, is committed to the Commission's expertise and discretion.

As the court observed in *Friedman* v. *United States,* 168 F. Supp. 815, 818 (S.D. N.Y. 1958), aff'd *per curiam* 359 U.S. 205, regarding exchange ratios for railroad stocks:

> "Because of the broad authority conferred upon the Commission by § 5 . . . and the technical complexities of a merger case, the doctrine of administrative finality is particularly applicable."

And, in *Penn-Central Merger Cases,* 389 U.S. 486, 524, the Court, noting that valuation of rail stocks involves "factors of particularized judgment and the weight to be ascribed to various values," stated:

> "These are matters as to which reasonable men may reasonably differ in detail. . . . We deem it our function, in the complexities of cases such as these, to review the judgment of the District Court with respect to agency actions to make certain that those actions are based upon substantial evidence and to guard against the possibility of gross error or unfairness. If we find those conclusions to be equitable and rational, it is not for us to second-guess each step in the Commission's process of deliberation."

Although many factors may be relevant in determining the relative contributions of the stockholders of merging carriers, including asset valuations where they are available, it has long been recognized that the value of a railroad "basically . . . is dependent upon the present and prospective earning power of the properties. . . ." *Chicago G.W.R. Co. Reorganization,* 247 I.C.C. 193, 196 (1941). And, as between physical values and earning power, "the physical values of the railroad properties are not controlling"; "the predominant factor is the earnings of the properties rather than their values." *Seaboard Air Line R. Co.—Merger—Atlantic Coast Line R. Co.,* 320 I.C.C. 122, 193 (1963).

In this case, the evidence compellingly demonstrates that the use of earning power as the primary determinant of the exchange ratios represented not merely an acceptable method of arriving at exchange ratios, but the only practical method.

As the record shows, the negotiators for GN and NP, and their financial advisers, thoroughly explored numerous alternatives before concluding that a valuation of either GN or NP stock except on the basis of earnings was

> "difficult if not impossible to make because of the diversity of the assets involved and the fact that neither railroad properties nor the natural resources were readily marketable and are worth only what they can earn." (App. 792).

The evidence submitted by NPSC confirmed, rather than contradicted this conclusion. Mr. Keplinger, the petroleum engineer and geologist employed by NPSC, supported the applicants' determination insofar as oil and gas properties were concerned, stating:

> "At best, it is difficult to arrive at the present worth of these unique and extensive oil and gas interests of Northern Pacific. At worst, it is impossible to place any exact valuation figures on them." (Tr. 10066)

Mr. Brundage testified that "The natural resource properties of Northern Pacific defy anything approaching an exact appraisal" (Tr. 9925), and Mr. Story added that "To measure the value of oil, timber or coal lands at the chance price of a given moment of time is likely to result in grave error" (Ex. 146, p. 4).

This Court has held that the use of comparative earnings to fix an exchange ratio is "reasonably conventional and generally accepted, always subject to the modifications and adaptations required by individual cases. . . ." *Penn-Cen-*

tral Merger Cases, 389 U.S. at 524. The Commission's acceptance of applicants' reliance on earnings as the primary basis for determining the exchange ratios was clearly within the broad authority conferred upon it by Section 5(2). See *Friedman* v. *United States,* 168 F. Supp. at 818.

Moreover, it is clear that the Commission gave weight "to the modifications and adaptions" required by the particular circumstances of this case in evaluating the agreed exchange ratios. As the Commission stated:

> "[U]ltimate determination of a fair and equitable exchange ratio is a matter of judgment based on a consideration of many factors." (App. 292)

As the Examiner's report shows, in this case these factors included the size and characteristics of the properties involved, the volume and composition of revenues, the relative debt structure of GN and NP, their performance ratios, the market values of their stocks, their dividend policies, estimates of future earnings, the appraisals of the NP natural resources properties, transportation efficiency, trends in traffic, financial position and earning power, historic and current earnings, and merger savings (App. 786-787, 794-795). First Boston, GN's financial adviser, gave greatest weight to the historic earnings of the railroad properties and to the current and prospective earnings of the natural resources properties (App. 794-795). Morgan Stanley, NP's adviser, gave weight to the fact that the preferred stock to be issued to GN stockholders recognized GN's historically higher earnings, dividends and market price, while the mandatory sinking fund requirement assured ultimate equality to the stockholders of NP (App. 794).

As an alternative to its insistence on an asset valuation, NPSC contends that all of the evidence concerning these myriad factors is unavailing. It asserts that, if earnings

are to be used as a method of fixing an exchange ratio, the record must contain expert testimony offered by applicants as to the appropriate price-earnings ratio for earnings from natural resources (NPSC Br. 24). It cites no authority for this proposition that various segments of the enterprise must be valued separately from the total, and, indeed, the authorities are to the contrary. See *Group of Institutional Investors* v. *Chicago, M., St. P. & Pac. R. Co.*, 318 U.S. 523, 561.

However, even if it were deemed necessary for applicants to supply such evidence, the requirement was met by the testimony of an officer of First Boston Corporation that income from the NP natural resources properties should be given a weight of about one-and-one-half to one as compared with railroad earnings (Tr. 2572; App. 794-795). For the five year period ending with 1960, the year the exchange ratios were agreed upon, the use of that factor to weight NP's natural resources income produces a ratio of one share of the merged company for GN stock and only 0.916 share for NP stock (Ex. 26, pp. 10, 14). On NPSC's assumption of a stock market value for rail earnings of 15 times those earnings, and using a value for NP's natural resources earnings of one-and-one-half times that ratio, the GN stockholders were entitled to a premium of more than $6.00 a share over NP stockholders. Under the exchange ratio agreed upon, they were given slightly less than $2.50, since the half share of $10.00 par value preferred they are to receive is to be redeemed from future earnings, more than half of which would otherwise have gone to the former GN stockholders (Tr. 122; App. 794). As the Commission found, on the basis of historic earnings, the merger terms favored the NP stockholders (App. 292).

The only evidence offered by NPSC in support of a higher price-earnings ratio for natural resources income was the testimony of Mr. Williams, who, on the basis of

comparisons with the market prices of the securities of three companies engaged in exploiting other properties, asserted that the NP properties should be valued at 50 times their latest earnings (Tr. 10000-01). The absurdity of this testimony was pointed up by the Examiner who noted that this basis produced a valuation for the NP's natural resources properties alone which was some $50 million more than the total stock market value of the *entire* NP, including the railroad properties (App. 810).

The Commission is the sole judge of the weight to be given the evidence before it, and the inferences to be drawn therefrom. *Corn Products Refining Co.* v. *F.T.C.*, 324 U.S. 726, 739; *Illinois Central R. Co.* v. *Norfolk & W. R. Co.*, 385 U.S. 57, 66, 69. Clearly it was under no duty to accept Mr. Williams' contentions.

NPSC's assertion that NP's natural resources properties should be valued at 50 times earnings has no more merit than its assertion that the negotiations between NP and GN were not conducted at arms' length (NPSC Br. 18-20). This latter claim was squarely rejected by the Examiner, who after analyzing these protracted and complex negotiations at length (App. 785-796), stated:

> "In its brief, intervener, NP Stockholders Committee, assert that the present merger terms were negotiated by persons well and long known to one another and were not the result of arms-length bargaining. Detailed review of the record reflects the contrary. True, the presidents of Great Northern and Northern Pacific were well known to one another and participated jointly or attentively in several common projects in which the companies they head hold a substantial interest. But the long, detailed and exhaustive negotiations, covering every conceivable aspect of the problem by those able and experienced individuals extending over a period of five years reflects the strongest dealing at arms' length, each concerned with representation

> of his company and its stockholders, in obtaining the highest possible values for those in which he had a concerned responsibility in the negotiations. Intervener's contention is without merit." (App. 796).[11]

Equally without merit is NPSC's criticism of the Commission's reliance on the fact that the negotiations were at arms' length, and on the stockholder approval of the negotiated ratios, in arriving at its conclusion that the terms are just and reasonable (NPSC Br. 21). As the Commission found in *Seaboard Air Line R. Co.—Merger—Atlantic Coast Line R. Co.*, 320 I.C.C. 122, 192 (1963), both extensive arms' length bargaining and stockholder approval of a stock exchange ratio, while not decisive, are strong evidence of the fairness of the terms. Stockholder approval "indicates that all of those directly affected had a full opportunity to evaluate the fairness of the plan in the light of their respective interests" (*ibid.*).

As the District Court found, the Commission made its own independent determination of the reasonableness of the exchange ratios, considering the prolonged negotiations involving arms' length bargaining as evidence of fairness, and the Commission's conclusion that the ratios fairly

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[11] NPSC also seeks to discount the fact that the negotiations were conducted at arms' length on the ground that these negotiations were conducted "under extreme compulsion to achieve a merger of railroad properties" (NPSC Br. 20). The fact that the presidents of *both* railroads felt a merger to be necessary (Tr. 155-156) in no way detracted from their relative bargaining strength. Rather, it resulted in a "realistic appraisal of the terms necessary to bring about acceptance by both sets of stockholders" (App. 292). This is another way of saying that the benefits of merger led to agreement on terms that were fair to both sides, rather than having one side or the other press for an unfair advantage. This is confirmed by the fact that the final agreement was approved by the independent financial advisers, who were under no compulsion other than to determine if the terms were fair to their own clients.

reflected the contributions of each group of stockholders to the combined system is amply supported by the record (App. 45).

II. THE DISTRICT COURT GAVE FULL CONSIDERATION TO NPSC'S EVIDENCE IN SUSTAINING THE COMMISSION'S FINDING THAT THE EXCHANGE RATIOS ARE JUST AND REASONABLE.

In reviewing the Commission's findings and conclusions, the District Court clearly and correctly recognized that its role was limited to determining whether the Commission had complied with the governing law and whether its conclusions were supported by findings based on substantial evidence (App. 20). *Penn-Central Merger Cases*, 389 U.S. 486, 498-499; *United States* v. *Pierce Auto Freight Lines, Inc.*, 327 U.S. 515, 535-536. Under these tests NPSC's attack on the decision of the District Court must fail.

NPSC's contention that the District Court failed to review the evidence offered by NPSC is merely an assertion that if its evidence had been considered, the Commission and the court would necessarily have concluded that the exchange ratios were not just and reasonable (NPSC Br. 26). As shown by the review of that evidence set forth above, this one-sided view of the record is wholly unwarranted.

The NPSC contention that, on the basis of market comparisons with stock of other companies, the NP natural resources income should be valued at 50 times earnings is absurd in the face of the market's valuation of the NP stock itself (see pp. 11-12, above).[12] And the NPSC's calculation

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[12] Even taking the highest price for NP stock in the four months of 1969, relied upon by NPSC, the stock market values NP at only $66 per share, and not $116.90 as calculated by NPSC (NPSC Br., App. VII, Sched. 2).

of stock exchange ratios on the basis of a $170 million valuation for the NP natural resources property (NPSC Br., App. II, Sched. 4) is equally absurd. Not even Mr. Sutton, NPSC's witness on its proposed sale of the properties, supported an evaluation of this magnitude, testifying instead that the properties were worth about $112 million to $117 million, before capital gains taxes (Tr. 10054). The $170 million figure, derived from the various appraisals of those properties, was also discounted substantially by the NP's independent financial adviser, Morgan Stanley & Co. (Ex. 32, p. 26). The raw appraisal evaluations upon which the $170 million figure is based did not take into account such matters as the capital gains taxes which would be payable if the properties were sold, and the NP management itself recognized that, even apart from tax considerations, the figure was much in excess of what the properties would actually bring if sold (App. 786).

As shown above, based on average earnings for the five-year period ending with the year in which the ratios were agreed upon, even if natural resources income is valued at 150 percent of railroad earnings, NP stockholders would be entitled to only 0.916 shares of stock, rather than share-for-share equality (p. 28, above). The preferred stock to be issued to the GN stockholders falls short of offsetting that difference. And if a valuation of $96 million is substituted for earnings in accordance with the method used by NPSC (NPSC Br., App. II, Sched. 4), the NP ratio drops to 0.904.[13]

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[13] NPSC's proposed price for a sale of the natural resources by NP to a land company was $96 million plus an amount to cover the capital gains taxes (p. 10, above).

Appellants' quibbles with the findings concerning their evidence (NPSC Br. 33-34) are like those of the plaintiffs in *Stott* v. *United States,* 166 F. Supp. 851, 862 (S.D. N.Y. 1958), where the court rejected a contention

> "that the Commission should have stated its reasons for rejecting numerous specific items of evidence which the minority adduced instead of giving its conclusions as to the various factors which it considered in general terms."

As the District Court found:

> "This whole matter [of the valuation of NP's natural resources properties], including the views advanced by the Committee, was explored in great detail by the Commission. On the basis of the record upon which the Commission relied, we have no reason to rule other than that the ratio which was established, with approval of the companies and of a large majority of their stockholders, is just and reasonable." (App. 45)

The fact that the District Court expressly chose not to discuss "specifically . . . each of the arguments advanced by the Committee" lends no weight to the NPSC claim that the District Court failed to review the record; the court's opinion clearly shows that "all significant issues regarding the ratio were fully considered . . ." (App. 46). The District Court was not required to advance a "theory of valuation" or a method for "determining just and reasonable stock exchange ratios" (NPSC Br. 35). Its task was to "review the . . . agency actions to make certain that those actions are based upon substantial evidence and to guard against the possibility of gross error or unfairness," not to "second-guess each step in the Commission's process of deliberation." *Penn-Central Merger Cases,* 389 U.S. at 524.

The conclusion of the District Court in *Fried* v. *United States,* 212 F. Supp. 886, 892 (S.D.N.Y. 1963), is appropriate here:

> "Based upon the record as a whole, . . . it is clear that the Commission properly applied the standards of the Act in its examination of the exchange ratio and that its findings are supported by substantial evidence. Basically, what plaintiffs want this Court to do is substitute its judgment for that of the Commission as to the importance in this context of factors which plaintiffs claim should have been given greater weight. . . . This we should not and will not do."

III. THE DISTRICT COURT'S CONCLUSION THAT THE COMMISSION HAD NOT ABUSED ITS DISCRETION IN REFUSING TO REOPEN THE RECORD WAS CLEARLY CORRECT.

NPSC contends that it was an abuse of discretion for the Commission to refuse to reopen the record in this proceeding to permit NPSC to relitigate the stock ratio issues with respect to which it had already been accorded a full hearing (NPSC Br. 37). NPSC argues that the stock exchange ratios must be determined on the basis of "facts... existing on a date as near as practically possible for the agency to the date of the consummation of the merger" (NPSC Br. 46). While NPSC disclaims any intention to require "that the Commission must continually keep granting further hearings on every fluctuation of earnings or circumstances," it claims that in this case there has been "a basic turnaround in earnings" and "radical changes in economic and monetary conditions" which require a reopening (NPSC Br. 39).

The NPSC position is unsound in law and fact. The mandate of *Schwabacher* v. *United States,* 334 U.S. 182, 199, that "In appraising a stockholder's position in a

merger as to justice and reasonableness, it is . . . current worth . . . that governs" does not require the reopening and updating of the record throughout the proceedings.[14] Proceedings under Section 5(2) of the Interstate Commerce Act are inevitably time consuming. See, *e.g.*, *Penn-Central Merger Cases*, 389 U.S. at 494-495. The transactions proposed cannot be consummated until they are approved by the Commission, and, more often than not, until that approval has been reviewed and upheld by the courts. Under these circumstances, if the determination of the fairness and reasonableness of the exchange ratios were required to be determined in close proximity to the date of consummation, no Section 5(2) proceeding would ever end.

Neither the statute nor the decisions construing it require such a result. Contrary to the NPSC contention, the "current worth" evaluated in determining the fairness of merger terms is ascertained on the basis of the record made before the Commission, and only in the most extreme cases will the Commission be required to reopen the record to take account of later data. As this Court has held, whether an administrative proceeding should be reopened to receive evidence of changed conditions is a question committed to the discretion of the administrative body, and its resolution of that question will not be disturbed unless there is "a showing of the clearest abuse of discretion." *United States* v. *Pierce Auto Freight Lines, Inc.*, 327 U.S. 515, 535.

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[14] In context, the references in *Schwabacher* to "current worth" served simply to distinguish the value of the stock as shown in the administrative record from the "value" of the stock as determined by the corporate charter. See *S.E.C.* v. *Central-Illinois Securities Corp.*, 338 U.S. 96, 134.

There is no merit to NPSC's assertion that "changes in the national economic and monetary conditions"—by which it means inflation—require reopening (NPSC Br. 44). The NPSC views on matters relating to "monetary inflation" are not new, for as NPSC pointed out in its petition to the Commission dated January 11, 1968:

> "This factor was stressed in all aspects of our Committee's direct case in the record. . . . It was the subject of extensive cross-examination of applicants' witnesses who negotiated and advised concerning the proposed merger terms." (Pet. 17)

Nor can NPSC deny that "monetary inflation" was taken into account in negotiating the merger terms (Tr. 1421); it simply continues to debate the degree to which it should be considered. Certainly the Commission has not abused its discretion in refusing to reopen the record on this matter. As the court appropriately observed in *Illinois Central R. Co.* v. *United States,* 263 F. Supp. 421, 434 (N.D. Ill. 1966), aff'd *per curiam* 385 U.S. 457:

> "Records in long and complex cases are inevitably outdated on the day of decision and the Commission has broad discretion to refuse to permit further delay to obtain evidence of changed conditions. Interstate Commerce Commission v. Jersey City, 322 U.S. 503, 514-515. . . . Compare Atchison, T. & S.F. R. Co. v. United States, 284 U.S. 248 . . . (Great Depression, rehearing required), with United States v. Pierce Auto Freight Lines, 327 U.S. 515, 535 . . . (World War II, rehearing denied)."

Nor do recent fluctuations in earnings or stock market prices represent the kind of change which would render the Commission's refusal to reopen the record an abuse of discretion. As the Court acknowledged in *Interstate Commerce Commission* v. *Jersey City,* 322 U.S. 503, 518, if

supervening events, and particularly changes in financial position, required administrative agencies to reopen their records, "final administrative disposition and judicial review may often be prevented altogether by the mere fact that they take time."

NPSC places primary reliance on earnings for the years 1967 and 1968, and stock market prices for four months in 1969, to argue that the Commission abused its discretion when, on January 4, 1967 (App. 251) and again on April 11, 1968 (App. 463, 470-471), it refused to reopen the record to allow NPSC to introduce updated data.[15]

Even if the 1967 and 1968 figures were considered, they do not demonstrate any basis for reopening this record.

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[15] NPSC studiously avoids mention of separate data for the years 1964-1966, included in the five-year averages used in its calculations and available to the Commission (App. 429). In 1964 and 1966, GN's earnings exceeded the total earnings of NP by $5.4 million and $5.9 million, and in 1965, by $8.9 million for an average excess of $6.7 million per year (NPSC Br., App. IV). Similarly, the average market price for GN's stock, which had exceeded that of NP by $4 per share in 1959-1960 (App. 799), exceeded that of NP by almost $7 per share in the 1964-1966 period. As to NP's income from natural resources properties, the average gross revenue for the 1964-1966 period ($11,810,082) was almost identical to that for 1959-1960 ($11,789,514). And the net revenues from this source showed a similar stability, averaging $6.4 million for 1964-1966 as compared with an average of $6.5 million for 1959-1960 (NPSC Br., App. V). If NPSC had prepared analyses for 1964-1966 similar to those shown in Schedule 3 of Appendix VII to its brief (valuing natural resources income at 150 percent of railroad income), the calculated exchange ratios would have been as follows:

Period	Ratio of NP to GN
1964	0.936
1965	0.851
1966	0.957
1965-1966 average	0.906
1964-1966 average	0.914

A one-year or two-year period is clearly too short a period from which to make comparative projections of relative earnings ability. From the standpoint of both total earnings and railroad earnings, 1967 and 1968 were bad years for both NP and GN, with earnings for both roads being lower than in the two preceding years, reflecting the drastic increases in labor expenses which resulted in the first general rate increases for railroads since 1960 (332 I.C.C. 280; 332 I.C.C. 590, 714). GN's earnings in those two years were also substantially affected by the fact that grain has been stored in unusually large quantities in country elevators and other interior storage points, awaiting resumption of the normal volume of grain shipments, and grain constitutes a disproportionately large part of GN's shipments as compared to NP. The fact that temporary dislocations of this kind could, and would, affect the relative incomes of these two railroads was fully recognized when the exchange ratios were approved (App. 797-798).

Furthermore, the fact that data for 1967 and 1968 became available since the date of the Commission's first report on reconsideration, approving the merger (November 30, 1967; App. 245) and, in the case of the 1968 data, since the District Court completed its review, does not support the NPSC claim to reopening. In *Erie-Lackawanna R. Co.* v. *United States,* 279 F. Supp. 316 (S.D.N.Y. 1967), aff'd *sub nom. Penn-Central Merger Cases,* 389 U.S. 486, the court upheld Commission-determined exchange ratios based on the 1965 earnings figures available at the time of the hearings, even though materially different 1966 earnings figures were not only available but were included in the record prior to the decision. The court stated:

> "The hearing examiner and the Commission having properly used 1965 figures, they were not required to start anew when the 1966 figures . . . became a part of the record. . . . These are simply raw figures which have not been analyzed to remove extraordinary items

or to place others on a full year basis; by the time the experts could do that and the Commission could render a new report, 1967 figures would be available and, on N&W's argument, the process must start again. The law does not compel an infinite regress." (279 F. Supp. at 340)

Taking the statistical criteria relied upon by NPSC one by one, for the entire period 1960-1968, GN's earnings have exceeded those of NP, on the average, by $2.9 million per year. For the past five years (1964-1968), despite the 1967 and 1968 results, GN's earnings have exceeded those of NP, on the average, by $2.5 million. In 1960, GN's earnings exceeded those of NP by $2.2 million.

With respect to natural resources, for the period 1964-1968, NP's gross income has averaged $13.1 million and its net income has averaged $7.0 million. If these figures are adjusted to eliminate $1.3 million of non-recurring income received in 1967, they become $12.9 million and $6.8 million, respectively. Such income levels represent only a modest increase over those for 1959-1960, when the average gross income was $11.8 million and the average net income $6.5 million. As to oil and gas revenues, the net income for 1968 ($3,558,000) was approximately the same as in 1960 ($3,552,375). Moreover, if 1967 oil and gas earnings are adjusted to eliminate non-recurring income, NP's net revenues from oil and gas have been less in every year 1960-1967 than they were in 1959, with the single exception of 1963 when an accounting change cumulated the revenues for 13 months, instead of 12.

As to market prices of the stocks, the average annual price of GN stock exceeded that of NP for each year 1964 through 1968. And for that period, GN stock averaged $5.10 per share more than that of NP, as compared with $4 per share in the 1959-1960 period considered by the Ex-

aminer (App. 799). Furthermore, for the year 1968, the stock market valued GN stock at 14 times its 1968 earnings, while NP, with all its natural resources income, was valued at only 11.8 times earnings.[16]

NPSC's continued insistence on a price-earnings ratio of 50 times earnings for natural resources income (NPSC Br. 49) is frivolous. Based on the stock market's 1968 appraisal, that ratio would produce a value for the natural resources properties alone some $65 million higher than the total market value of NP's stock. On NPSC's assumption that railroad earnings should be valued at a price-earnings ratio of 15 (NPSC Br., App. II, Sched. 3), the stock market values NP's natural resources income at a price-earnings ratio of about 9, not 50.[17]

The District Court appraised the allegations upon which NPSC relies to support its claim that the Commission abused its discretion in refusing to reopen these proceedings. The court was clearly correct in disposing of those allegations and the requested reopening:

> "[S]uch fluctuations as the Committee refers to as possibly relevant are, as the Commission now urges, those normal fluctuations which can be expected to occur during the course of any protracted administra-

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[16] Similarly, NP attained its highest market price for the first five months of 1969 in February. This price was 14.1 times its 1968 earnings, while that of GN, for the same month, was 15.6 times its 1968 earnings.

[17] At the average market price of NP stock for 1968 ($55.44), the total value of its shares would be $331,229,163. If its 1968 railroad earnings of $3.36 per share are valued at 15 times those earnings, the total capitalized value would be $258,516,540. The difference between the total market value of NP shares and the capitalized value of its railroad earnings—$72,712,623—would represent the market's evaluation of its $7,950,000 in income from natural resources, reflecting a ratio of about 9 times those earnings.

tive proceeding and which have no effect upon the ultimate fairness of the Commission's finding." (App. 45-46)

IV. THE COMMISSION'S FINDING THAT THE NPSC PLAN FOR SEGREGATION AND SALE OF THE NP NATURAL RESOURCES PROPERTIES WAS WITHOUT MERIT AND UNFAIR TO NP STOCKHOLDERS WAS SUPPORTED BY SUBSTANTIAL EVIDENCE.

NPSC contends that the Commission's findings rejecting its proposed condition requiring the segregation and sale of the natural resources properties of NP prior to consummation of the merger are not supported by substantial evidence. It further contends that the District Court failed to review the record on this point and to make express findings concerning it (NPSC Br. 51-55).

Neither contention is valid. The Commission gave full consideration to the NPSC plan (App. 293-297), as did the Examiner (App. 808-813). The Commission found NPSC's proposed condition (NPSC Br., App. III) "to be no real answer, involving as it does, a requirement that, in effect, all Northern Pacific stockholders repurchase interests in property they already own, with those failing to do so frozen out of future benefits therefrom," and concluded that the NPSC "contentions relative to the suggested condition . . . are . . . without merit and unfair to Northern Pacific stockholders. . ." (App. 296-297, 470-471). This conclusion is fully supported by the evidence.

As shown by the evidence reviewed above (pp. 14-15), the proposal is unfair to the NP stockholders for the following reasons:

1. To retain the interest in the natural resources properties which they now have, stockholders would be required

to purchase stock in the proposed land company, which is the equivalent of forcing them to repurchase an interest in property they already own.

2. Those who failed to buy land company stock would be frozen out of all future participation in the natural resources.

3. Negotiable rights to subscribe for land company shares issuable to the stockholders would be ostensibly saleable, but there is no assurance that they would have any value or be marketable; and, even if they were saleable, the rights would be dubious compensation for the loss of the natural resources by those who do not choose to exercise such rights.

4. There is no assurance that underwriters could be found to complete the financing of the proposed cash purchase of the natural resources; they would have to be prepared to provide all of the cash necessary for the purchase from NP on the assumption that no stockholder would purchase land company shares, except perhaps Mr. Brundage and his associates.

Moreover, while NPSC argues that the merger terms require all NP stockholders to lose forever more than 50 percent of their interest in the natural resources, it ignores the fact that they will gain the right to participate in GN earnings available for common stock dividends. Again, while NPSC asserts that its plan gives each stockholder an option to continue his 100 percent interest in the natural resources by selling all or sufficient shares of NP to pay for stock in the new land company, it does not mention that the proceeds of the stock sale would be taxable as capital gains. And, while NPSC relies upon the fact that the market value of the NP stock has been more than twice the proposed sub-

scription price of the new land company stock in the past, it did not and could not offer the slightest evidence of what the market prices of either or both stocks would be in light of the sale proposed by NPSC.

NPSC also ignores the fact that the cash derived by NP from any sale of its properties would be deposited under two existing mortgages and usable by the merged company only subject to highly restrictive conditions over a long period of years; that the trustees of the mortgages would refuse to release the property for sale without litigation of doubtful result; that the new land company would have its cash depleted by organization expenses and underwriting commissions in an undetermined amount; that the prospective earnings and dividends on investment in the new land company are wholly undetermined; that the stockholders of all of the merging companies would have to concur in the proposal to change the merger terms; that the NP stockholders have twice approved the agreed terms in overwhelming percentages, even though NPSC placed the essence of its proposal before all stockholders in urging them not to vote at the meeting on March 14, 1968; and that revised merger agreements would have to be resubmitted to the Commission for approval at the expense of serious delays in realizing the annual savings of nearly $40,000,000 to be generated by the merger (see pp. 14-16, 18-19, above).

The District Court pointed to the primary obstacle to any proposal such as that advanced by NPSC, noting that segregation of the natural resources properties "would create problems with mortgage trustees and bond holders, with the prospect of extended litigation and the probability that it could never be consummated successfully" (App. 44). It further took account of the fact that, before the

Commission, NPSC's "real objection was to the inclusion of the natural resources," and that the Commission had explored in detail "the views advanced by the Committee" (App. 45). It disposed of the NPSC contention concerning its proposed condition by stating that "although we have not specifically discussed each of the arguments advanced by the Committee, we think all significant issues regarding the ratio were fully considered and decided in a manner which requires the court to withhold any direction of its own that the ratio should be different" (App. 46). Nothing more was required. *Minneapolis & St. L. Ry. Co.* v. *United States,* 361 U.S. 173, 193-194.[18]

CONCLUSION

The exchange ratios between GN and NP were studied and negotiated at length and fairly reflect the contributions of each group of stockholders to the combined system. The ratios have been approved by expert financial advisers, twice by stockholders, by the Hearing Examiner, by the Commission and by the three-judge District Court. NPSC

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[18] The applicants' proposal for a merger, including the NP natural resources, and that of NPSC for segregation and sale prior to merger are mutually exclusive. The Commission's conclusion that the applicants' proposal was just and reasonable required that it authorize that transaction (49 U.S.C. Sec. 5(2)(b)), which in turn required it to reject the NPSC proposal. NPSC was required to show not merely that its proposal was just and reasonable, but that the applicants' proposal was not. Even if both proposals were found to be just and reasonable, the Commission was justified in authorizing that of applicants in preference to that of NPSC, since there was no assurance that the NPSC proposal, even if approved, could ever be consummated. See *Toledo, P. & W. R. Co. Control,* 295 I.C.C. 523, 546-547 (1957).

presents no significant legal or factual issue demonstrating that this approval should be set aside. Accordingly, the judgment below should be affirmed.

Respectfully submitted,

ANTHONY KANE
LOUIS E. TORINUS
EARL F. REQUA
FRANK S. FARRELL
ELDON MARTIN
R. T. CUBBAGE

RICHARD J. FLYNN
1625 I Street, N.W.
Washington, D.C. 20006

HUGH B. COX
888 Sixteenth Street, N.W.
Washington, D.C. 20006

RAY GARRETT
D. ROBERT THOMAS
LEE B. MCTURNAN
11 South LaSalle Street
Chicago, Illinois 60603

Attorneys for Great Northern Railway Company, et al., Appellees

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